**DEPARTMENT OF STATE REVENUE**

04-20100698.SLOF

**Supplemental Letter of Findings: 04-20100698**
**Gross Retail Tax**
**For the Years 2006, 2007, and 2008**

**NOTICE:** Under IC § 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of the document will provide the general public with information about the Department's official position concerning a specific issue.

## ISSUES

**I. Refrigeration Equipment – Gross Retail Tax.**

**Authority**: IC § 6-2.5-1-2; IC § 6-2.5-2-1(a); IC § 6-2.5-2-1(b); IC § 6-2.5-3-1(a); IC § 6-2.5-3-2(a); IC § 6-2.5-4-1(b), (c); IC § 6-2.5-5-3(b); IC § 6-8.1-5-1(c); Rhoade v. Ind. Dep't of State Revenue, 774 N.E.2d 1044 (Ind. Tax Ct. 2002); Mynsberge v. Dep't of State Revenue, 716 N.E.2d 629 (Ind. Tax Ct. 1999); Tri-States Double Cola Bottling Co. v. Dep't of State Revenue, 706 N.E.2d 282 (Ind. Tax Ct. 1999); Hudson Foods, Inc. v. Indiana Department of Revenue, No. 49T10-9711-TA-192 (Ind. Tax Ct. Oct. 7, 1999); USAir, Inc. v. Ind. Dep't of State Revenue, 623 N.E.2d 466 (Ind. Tax Ct. 1993); General Motors Corp. v. Indiana Dept. of State Revenue, 578 N.E.2d 399 (Ind. Tax Ct. 1991); Indiana Dept. of State Revenue v. Kimball Int'l Inc., 520 N.E.2d 454 (Ind. Ct. App. 1988); 45 IAC 2.2-5-8(b); 45 IAC 2.2-5-8(g); Ind. Tax Ct. R. 17.

Taxpayer disagrees with the Department's decision concluding that certain of its refrigeration equipment was exempt from gross retail tax and that certain refrigeration equipment was not exempt.

**II. Evaporation Equipment – Gross Retail Tax.**

**Authority**: General Motors Corp. v. Indiana Dept. of State Revenue, 578 N.E.2d 399 (Ind. Tax Ct.1991); Indiana Dep't of Revenue v. Kimball Int'l, Inc., 520 N.E.2d 454 (Ind. Ct. App. 1988); 45 IAC 2.2-5-8(c); 45 IAC 2.2-5-8(j); Letter of Findings 04-20100698 (June 15, 2011).

Taxpayer maintains that its purchase of evaporation equipment was not subject to sales/use tax because the evaporation equipment related to the direction production of Taxpayer's food products.

**III. Production Equipment Repair Parts – Gross Retail Tax.**

**Authority:** IC § 6-2.5-5-3(b); General Motors Corp. v. Indiana Dept. of State Revenue, 578 N.E.2d 399 (Ind. Tax Ct. 1991); 45 IAC 2.2-5-8(f)(3); 45 IAC 2.2-5-8(f)(4); 45 IAC 2.2-5-8(h)(2).

Taxpayer states that its purchase of repair parts for a "cage dumper" are exempt from sales/use tax because these items are directly used in the direct production of Taxpayer's food products.

**IV. Computer Parts – Gross Retail Tax.**

**Authority**: 45 IAC 2.2-5-8(c)(5); 45 IAC 2.2-5-8(d); Letter of Findings 04-20100698 (June 15, 2011).

Taxpayer argues that it was not required to pays sales or use tax on the purchase of certain computer components because the computer components are directly used in the direct production of animal feed.

**V. Chemical Coolant – Gross Retail Tax.**

**Authority**: IC § 6-8.1-5-1(c); 45 IAC 2.2-5-8(c); Letter of Findings 04-20100698 (June 15, 2011).

Taxpayer maintains that it was not required to pay sales or use tax on the purchase of propylene glycol because this coolant is directly used in the direct production of Taxpayer's food products.

## STATEMENT OF FACTS

Taxpayer is a business which produces various food products. Taxpayer breeds and raises animals which it uses to produce its food products. These animals are raised on farms which Taxpayer does not own although Taxpayer retains title to the animals throughout the entire process. In addition, taxpayer operates meat processing plants in Indiana and outside Indiana. After completion of the manufacturing process, the food product is sold to a related entity which is responsible for generating sales of Taxpayer's products and well as delivering the products to customers in Indiana and other states. Taxpayer also owns an Indiana animal feed mill.

The Indiana Department of Revenue (Department) conducted an audit review of Taxpayer's business records. Taxpayer and the Department agreed to a "statistical sampling methodology to estimate the additional purchases subject to use tax...." The Department found that Taxpayer had accrued use tax but had not paid those amounts to the state.

After completing the audit review, the Department concluded that Taxpayer owed additional sales/use tax. Taxpayer disagreed with a portion of the assessment and submitted a protest to that effect. An administrative hearing was conducted during which Taxpayer's representatives explained the basis for its protest. A Letter of Findings was issued June 2011 which denied Taxpayer's protest in part and sustained Taxpayer's protest in part. Taxpayer disagreed with the June 2011 Letter of Findings, requested a rehearing on the disputed issues, and was granted that rehearing. A second administrative hearing was conducted during which Taxpayer's representatives repeated or further explained its objections. This Supplemental Letter of Findings results.

**I. Refrigeration Equipment – Gross Retail Tax.**

## DISCUSSION

Taxpayer purchased refrigeration equipment later installed at Taxpayer's manufacturing facility. Taxpayer's refrigeration system consists of four separate sections called a (1) "work-in-process" cooler, (2) a spiral freezer, (3) a blast freezer, and (4) a 20 below finished goods freezer.

Taxpayer objected to the audit's determination that the 50 percent of the equipment was exempt from sales tax and 50 percent was not exempt from sales/use tax. As noted in the June 2011 Letter of Findings, the audit summary addressed the issue as follows:

> [Taxpayer's] refrigeration system consists of four... separate sections: a work in process cooler, a spiral freezer used during the process, a blast freezer used after packaging, and a 20 below finished goods freezer used in storage areas to maintain temperature of completed products until shipped. According to plant engineers, the blast freezer and the 20 below finished goods freezer comprised 50[percent] of the refrigeration system and the remaining 50[percent] was work in process refrigeration. Therefore [Taxpayer's] refrigeration system was considered to be used 50 percent of the time in taxable operations within the facility.

The June 2011 Letter of Findings concluded that the 50 percent of the refrigeration equipment "simply maintains the food product in its frozen state[] and does have 'an immediate effect upon the article being produced.'"

Indiana imposes an excise tax called "the state gross retail tax" (or "sales tax") on retail transactions made in Indiana. IC § 6-2.5-2-1(a). A person who acquires property in a retail transaction (a "retail purchaser") is liable for the sales tax on the transaction. IC § 6-2.5-2-1(b). Indiana also imposes a complementary excise tax called "the use tax" on "the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction." IC § 6-2.5-3-2(a). "Use" means the "exercise of any right or power of ownership over tangible personal property." IC § 6-2.5-3-1(a). The use tax is functionally equivalent to the sales tax. See Rhoade v. Ind. Dep't of State Revenue, 774 N.E.2d 1044, 1047 (Ind. Tax Ct. 2002). By complementing the sales tax, the use tax ensures that non-exempt retail transactions (particularly out-of-state retail transactions) that escape sales tax liability are nevertheless taxed. Id. at 1047; USAir, Inc. v. Ind. Dep't of State Revenue, 623 N.E.2d 466, 468–69 (Ind. Tax Ct. 1993). The use tax ensures that, after such goods arrive in Indiana, the retail purchasers of the goods bear their fair share of the tax burden. To trigger imposition of Indiana's use tax, tangible personal property must (as a threshold matter) be acquired in a retail transaction. Rhoade, 774 N.E.2d at 1047. A taxable retail transaction occurs when; (1) a party acquires tangible personal property as part of its ordinary business for the purpose of reselling the property; (2) that property is then exchanged between parties for consideration; and (3) the property is used in Indiana. See IC § 6-2.5-1-2; IC § 6-2.5-4-1(b), (c); IC § 6-2.5-3-2(a).

The state gross retail tax does not apply to sales of manufacturing machinery, tools, and equipment to be directly used by the purchaser in the direct production, manufacture, fabrication, assembly, or finishing of tangible personal property. Indiana imposes an excise tax called "the state gross retail tax" (or "sales tax") on retail transactions made in Indiana. IC § 6-2.5-2-1(a). A person who acquires property in a retail transaction (a "retail purchaser") is liable for the sales tax on the transaction. IC § 6-2.5-2-1(b).

The June 2011 Letter of Findings, stated that, "Taxpayer believes the cooling equipment is exempt from both sales and use tax pursuant to 45 IAC 2.2-5-8(b)." The regulation states as follows:

> The state gross retail tax does not apply to sales of manufacturing machinery, tools, and equipment to be directly used by the purchaser in the direct production, manufacture, fabrication, assembly, or finishing of tangible personal property. (Emphasis added).

In Taxpayer's rehearing request, Taxpayer states that, "Taxpayer produces and sells a frozen product [and] any equipment used to lower the temperature of the product should be considered to be exempt production equipment pursuant to IC § 6-2.5-5-3." The statute reads in part as follows.

> [T]ransactions involving manufacturing machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it for direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property. IC § 6-2.5-5-3(b).

Taxpayer believes that all the refrigeration equipment should be exempt including the blast freezer, the finished goods freezer, "work-in-process" cooler, and spiral freezer as opposed to the audit's conclusion which stated, "[Taxpayer's] refrigeration system was considered to be used 50[percent] of the time in taxable operations within the facility."

As a threshold issue, it is the Taxpayer's responsibility to establish that the existing tax assessment is incorrect. As stated in IC § 6-8.1-5-1(c), "The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made."

In applying any tax exemption, the general rule is that "tax exemptions are strictly construed in favor of taxation and against the exemption." Indiana Dept. of State Revenue v. Kimball Int'l Inc., 520 N.E.2d 454, 456 (Ind. Ct. App. 1988).

45 IAC 2.2-5-8(b) and IC § 6-2.5-5-3 like all tax exemption provisions, are strictly construed against exemption from the tax. Tri-States Double Cola Bottling Co. v. Dep't of State Revenue, 706 N.E.2d 282, 283 (Ind.

Tax Ct. 1999); Mynsberge v. Dep't of State Revenue, 716 N.E.2d 629, 636 (Ind. Tax Ct. 1999). Nevertheless, the Department is well aware of the countervailing rule that a "statute must not be construed so narrowly that it does not give effect to legislative intent because the intent of the legislature embodied in a statute constitutes the law." General Motors Corp. v. Indiana Dept. of State Revenue, 578 N.E.2d 399, 404 (Ind. Tax Ct. 1991).

In support of its argument that all of its refrigeration equipment was exempt, Taxpayer cites to Hudson Foods, Inc. v. Indiana Department of Revenue, No. 49T10-9711-TA-1 (Ind. Tax Ct. 1999) in which the court found that dry ice was "consumed" in the production of the petitioner's poultry meat products. Taxpayer maintains that the disputed refrigeration equipment is "identical to the use of dry ice in Hudson Foods." Taxpayer believes that any equipment used to lower the temperature of Taxpayer's food product is exempt. However, the Department must question whether or not Taxpayer is entitled to cite to an unpublished opinion whether or not the petitioner in Hudson Foods and the Taxpayer are closely related. Ind. Tax Ct. R. 17 states,

> All judgments shall be incorporated in written memorandum decisions by the court. Unless specifically designated "For Publication," such written memorandum decisions shall not be published and shall not be regarded as precedent nor cited before any court except for the purpose of establishing the defense of res judicata, collateral estoppel, or the law of the case. Judgment shall be subject to review as prescribed by relevant Indiana rules and statutes.

The Department does not agree that the decision in Hudson Foods is dispositive on this protest issue because the refrigeration equipment here at issue is used to maintain the temperature of frozen foods once that food has been prepared, and the dry ice at issue in Hudson Foods was consumed in the production of that petitioner's food products.

The Department finds no reason to disagree with the audit's conclusion that two of the four refrigeration units ("work-in-process cooler" and "spiral freezer") are used in the direct production of Taxpayer's food product and that these two items of equipment have a direct effect on those products. However, the Department must conclude that the exemption statutes draws a distinction between refrigeration equipment which has a direct and immediate effect and refrigeration equipment which is used to maintain, store, or preserve products when the production of those products has been completed. For example, refrigeration equipment which is used to transform water into marketable ice cubes is likely exempt pursuant to IC § 6-2.5-5-3(b) but refrigeration equipment used to maintain those same ice cubes in their frozen state – such as that equipment found in the ice manufacturer's warehouse or found in a local supermarket – is not exempt.

As noted in the June 2011 Letter of Findings, the Department does not question Taxpayer's assertion that all of its refrigeration equipment is necessary to the production of Taxpayer's food product. However, there is a distinction between equipment which is "necessary" and equipment which is exempt. To that end, it should be noted that the regulation also explains in part as follows:

> The fact that particular property may be considered essential to the conduct of the business of manufacturing because its use is required either by law or by practical necessity does not itself mean the property " has an immediate effect upon the article being produced." Instead, in addition to being essential for one of the above reasons, the property must also be an integral part of an integrated process which produces tangible personal property. 45 IAC 2.2-5-8(g). (Emphasis added).

IC § 6-8.1-5-1(c) requires that a taxpayer bear the burden of demonstrating that a proposed assessment is "wrong." Bearing in mind that "all tax exemption provisions, are strictly construed against exemption from the tax," the Department concludes that the June 2011 Letter of Findings and the original audit correctly distinguished between refrigeration equipment which was exempt and refrigeration equipment which is "necessary" but was not exempt.

**FINDING**

Taxpayer's protest is respectfully denied.

**II. Evaporation Equipment – Gross Retail Tax.**

**DISCUSSION**

Taxpayer purchased evaporation equipment which – in its initial protest letter – Taxpayer described as "used to evaporate moisture from the air and [food] product."

The audit report stated that the evaporators are "used as part of the cooling system at [Taxpayer's] plant [and] are used in all air conditioning systems to remove moisture." The audit noted that the evaporators do help to keep moisture out of the plant but disagreed as to the applicability of the exemption stating that "there was no positive causal effect on tangible personal property." The audit found the evaporation equipment was subject to tax pursuant to 45 IAC 2.2-5-8(j) which states as follows:

> Managerial, sales, and other non-operational activities. Machinery, tools, and equipment used in managerial sales, research, and development, or other non-operational activities, are not directly used in manufacturing and, therefore, are subject to tax. This category includes, but is not limited to, tangible personal property used in any of the following activities: management and administration; selling and marketing; exhibition of manufactured or processed products; safety or fire prevention equipment which does not have an immediate effect on the product; space heating; ventilation and cooling for general temperature control; illumination; heating equipment for general temperature control; and shipping and loading. (Emphasis added).

In its request for a rehearing, Taxpayer argues that the analysis set out in the June 2011 Letter of Findings was flawed. Taxpayer states, "If the environmental equipment has a purposeful effect on the [Taxpayer's] food product, then it is an exempt part of the production process." The June 2011 Letter of Findings to which Taxpayer objects concluded as follows:

> While using the evaporators can be an element of the manufacturing process, merely managing or conditioning the air environment of an entire plant, by itself, is not manufacturing. Second, only clearly demarcated areas in which there is active manufacturing that depends on a controlled environment are entitled to the exemption. For example, paint booths or finishing stalls within a plant are such areas. The mere fact that the food processing occurs within an open area of a plant does not mean the evaporators are exempt, unless the size and volume of the manufactured product is so large as to dwarf the plant and render the whole interior an integral part of the processing facility. In Taxpayer's facility, the evaporators operate to "condition" the environment within that facility rather than a specific, demarcated area within that facility. Letter of Findings 04-20100698 (June 15, 2011).

As noted in Part I above, "In applying any tax exemption, the general rule is that 'tax exemptions are strictly construed in favor of taxation and against the exemption.'" Indiana Dept. of State Rev. v. Kimball Int'l Inc., 520 N.E.2d 454, 456 (Ind. Ct. App. 1988). Taxpayer asks that the Department conclude that equipment used to "condition" the environment within Taxpayer's facility is entirely exempt, but the Department must respectfully decline that invitation. The Department believes that its interpretation and application of 45 IAC 2.2-5-8(c) is not such a "narrow interpretation" of the exemption that the Department's conclusion ignores "the intent of the legislature embodied in a statute...." General Motors Corp. v. Indiana Dept. of State Revenue, 578 N.E.2d 399, 404 (Ind. Tax Ct.1991).

However, Taxpayer raises an additional issue related to the same evaporation equipment. Taxpayer explains that this equipment is part-and-parcel of the refrigeration equipment addressed in Part I which found that two of the Taxpayer's refrigeration units were exempt from sales/use tax because those units had a direct and immediate effect on Taxpayer's food product. Presumably, Taxpayer's "evaporation equipment" consists of compressors, condensers, and the like which – in part – are integral to the function of the exempt equipment. To the extent that Taxpayer is able to delineate the extent to which the evaporation equipment is related to the exempt refrigeration equipment, the audit division is requested to adjust the sales/use tax assessment.

**FINDING**

Taxpayer's protest is sustained in part and denied in part.

**III. Production Equipment Repair Parts – Gross Retail Tax.**

**DISCUSSION**

Taxpayer purchased replacement parts for a "cage dumper." Taxpayer explained that the cage dumper "releases the birds from their original state of confinement and allows them to be placed on the production line for further processing." Taxpayer maintains that the release of the birds constitutes "the first step in materially affecting the product in the production process."

If – as Taxpayer asserts – the "cage dumper" is directly involved in the direct production of Taxpayer's food products, the replacement parts for the "cage dumper" are also exempt. See IC § 6-2.5-5-3(b). The issue of replacement parts is addressed at 45 IAC 2.2-5-8(h)(2) which states:

> Replacement parts, used to replace worn, broken, inoperative, or missing parts or accessories on exempt machinery and equipment are exempt from tax.

Therefore, in order to find that the replacement parts are exempt, the "cage dumper" must be directly used in the direct production of Taxpayer's food products. However, the June 2011 Letter of Findings concluded that, "Based on Taxpayer's description, the cage dumper is best categorized as moving the raw materials 'prior to their entrance into the production process....' under 45 IAC 2.2-5-8(f)(1)." ("Tangible personal property used for moving raw materials to the plant prior to their entrance into the production process is taxable.")

Taxpayer argues that the Department takes too narrow a view of Taxpayer's food processing operation; that food processing operation consists of third-party breeders, meat processing plants, and distribution and marketing facilities which constitutes a single integrated production process. See 45 IAC 2.2-5-8(f)(4).

General Motors Corp. v. Indiana Dept. of State Revenue, 578 N.E.2d 399 (Ind. Tax Ct. 1991) aff'd 599 N.E.2d 588 (Ind. 1992) is an Indiana Supreme Court decision addressing the issue of whether the petitioner's manufacturing plants constituted a continuous, integrated production process. In General Motors, the automobile manufacturer shipped component automobile parts to its plants and claimed an exemption for the purchase of items employed in the transfer of those components parts from facility to facility. The court held that the automobile manufacturer's packing materials were part of the integral process whereby the manufacturer produced its finished product. Therefore, the court held that automobile manufacturer's packing materials were exempt under IC § 6-2.5-5-3. The court reached that decision after finding the automobile manufacturer's separate production facilities formed an uninterrupted, singular production unit in which the petitioner's "manufacture of finished marketable automobiles [was] accomplished by one continuous integrated production process within which the transport of parts from component plants to assembly plants [was] an essential and integral part." General Motors, 578 N.E.2d at 404.

In finding that the automobile manufacturer's production process encompassed manufacturing activities performed at multiple sites, the court identified a number of significant facts. Specifically, the court found that "[t]he facts in the case [FN3] as well as previous judicial findings [FN4] indicate GM's production process is by nature highly integrated. The court's sole concern, however, is whether GM's manufacturer of finished automobiles qualifies as one continuous integrated production process for the purpose of exemption from sales/use tax." Id. at 402.

Footnote three gives some indication of the evidence which the court relied in arriving at a conclusion that petitioner GM's production was both "continuous" and "integrated." Specifically, the court found that "GM's component plant personnel collaborate with the assembly plant personnel (1) to develop new product concepts, (2) to individually design, engineer, and test the performance of new parts and packing materials, (3) to plan the layout and production processes for new parts, (4) to coordinate production schedules because delays at one plant would have an immediate effect on the other plants, and (5) to solve problems and ensure quality control." Id. at n.3. In addition, the court noted that a "continuity of production exists between GM's different plants [which is] demonstrated by the standard practice of shifting certain production operations back and forth between component and assembly plants when necessary for more efficient operation." Id.

It was in the context of these particularized facts and findings that the court held that GM's manufacture of automobiles represented one "continuous integrated production process." Id. at 404. It was in the context of these particularized facts and findings that the court held that GM's assembled automobiles, and not the automobile's component parts, constituted the taxpayer's most marketable product and that the production of the "most marketable product" constituted the conclusion of GM's integrated but physically discontinuous manufacturing process.

Taxpayer produces food products. Taxpayer raises animals at third-party locations, transfers those animals to processing plants, and then transfers the food product to distribution facilities. Assuming that "production" occurs at the third-party locations and – as described in this Supplemental Letter of Findings – production occurs at the processing plants, Taxpayer believes that the "cage dumper" is exempt because the production of its food "[is] accomplished by one continuous integrated production process...." General Motors, 578 N.E.2d at 404. The Department is unable to agree that Taxpayer's production process meets the standard set out in General Motors. There is no evidence of an integrated collaboration within Taxpayer's facilities, coordination of production facilities, of "shifting certain production operations back and forth between... plants when necessary for more efficient operation," or of collaboration between the facilities to produce new products. Id. at n.3.

The "cage dumper" replacement parts are not exempt because the "cage dumper" is best categorized as "[t]ransportation equipment used to transport work-in-process or semi-finished materials to or from storage...." 45 IAC 2.2-5-8(f)(3).

**FINDING**

Taxpayer's protest is respectfully denied.

**IV. Computer Parts – Gross Retail Tax.**

**DISCUSSION**

Taxpayer purchased a "power supply for a micro feed additive system." Taxpayer installed the power supply on a computer. According to Taxpayer, the computer is used to "control[] the amount and type of poultry feed ingredients that go into making poultry feed." Taxpayer further explained that "the computer controls the introduction of the correct mix of micro ingredients based on the batch size and nutritional need."

The relevant regulation is 45 IAC 2.2-5-8(c)(5) which states:

> A computer is used to control and monitor various aspects of the plating and surface-treatment operations in Example (1). The computer is located in a separate room in a different part of the plant from the plating and surface-treatment operations but is connected to the equipment comprising those operations by means of electrical devices. The computer equipment, including related terminals, printer, and memory, data storage, and input/output devices, is exempt because its use in this manner is an integral and essential part of the integrated production process. (Emphasis added).

The audit report does not directly address the question of whether the power supply is or is not subject to sales use/tax but simply notes that items assessed in the "stat sample" included "a computer and related software used in measuring raw materials prior to the mixer." The audit report would seem to suggest that the computer is used before production of the feed begins. If so, 45 IAC 2.2-5-8(d) is relevant:

> Pre-production and post-production activities. "Direct use in the production process" begins at the point of the first operation or activity constituting part of the integrated production process and ends at the point that the production has altered the item to its completed form, including packaging, if required.

The June 2011 Letter of Findings explained:

> The issue is whether the computer equipment and software function before the production of poultry feed occurs or whether the equipment and software control the actual production of the poultry feed. Do the computer equipment and software "have an immediate effect on the article being produced" and do the computer equipment and software constitute "an essential and integral part of an integrated process which produces tangible personal property"? 45 IAC 2.2-5-12(c). Letter of Findings 04-20100698 (June 15, 2011).

On the issue of Taxpayer's computer power equipment, the Department found in the original Letter of Findings that there was insufficient information on which to conclude that the equipment was directly used in the direct production of Taxpayer's food product. As stated in that Letter of Findings, "Without more specific information as to this particular equipment... it is not possible to conclude that the audit was incorrect and that Taxpayer is entitled to the exemption." Taxpayer has supplemented those initial objections and explanations stating that, "The computer equipment at issue controls the amount of supplements, such as vitamins and minerals which are added to chicken feed produced by [Taxpayer]." In addition, Taxpayer provided a "production schematic" indicating where in the feed production process the computer power equipment is used. The Department is prepared to agree that Taxpayer has met its burden of establishing that the computer power equipment is exempt and that Taxpayer is entitled to a "credit" for the amount of sales tax Taxpayer paid when it first acquired the computer equipment.

**FINDING**

Taxpayer's protest is sustained.

**V. Chemical Coolant – Gross Retail Tax.**

**DISCUSSION**

Taxpayer purchased a chemical called "propylene glycol." When Taxpayer bought this chemical, it paid use tax. Subsequent to the audit, Taxpayer came to the conclusion that the chemical should not have self-assessed use tax on the ground that the chemical "is used directly in the production process by cooling a marinade that becomes part of the final product." The Department's audit did not disagree that use tax was paid but the written "Summary" does not appear to address the issue; there is nothing apparent in the "Summary" which found that Taxpayer was or was not entitled to a "credit" for use tax paid on an item which was later found to be exempt. The June 2011 Letter of Findings contained the following explanation which Taxpayer – during the subsequent rehearing – did not specifically challenge.

> Taxpayer explains that the "chemical directly affects the marinade by chilling to near freezing without freezing the liquid marinade." Taxpayer further explains that the "propylene glycol allows [Taxpayer] to lower the temperature of the marinade that is coated/impregnated upon [Taxpayer's] processed chickens to almost freezing without creating ice." Taxpayer concludes that the chemical has "a direct affect to an ingredient of the production and is consumed in the manufacturing process." Letter of Findings 04-20100698 (June 15, 2011).

As noted in the June 2011 Letter of Findings, Taxpayer cited to 45 IAC 2.2-5-8(c) as authority for its argument that the coolant is exempt.

> The state gross retail tax does not apply to purchases of materials to be directly consumed in the production process or in mining, provided that such materials are directly used in the production process; i.e., they have an immediate effect on the article being produced. The property has an immediate effect on the article being produced if it is an essential and integral part of an integrated process which produces tangible personal property.

The original Letter of Findings stated that, "The only thing which is known with any certainty is that propylene glycol has numerous uses" but that Taxpayer had failed to provide evidence that that proposed assessment – any by implication that the purchase of the coolant should have been exempt – was incorrect. IC § 6-8.1-5-1(c) states that, "The notice of proposed assessment is prima facie evidence that the department claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." Taxpayer renewed its concerns on this issue during the rehearing stating that "this coolant is utilized by a machine which produces marinades which are used by [Taxpayer] marinade or inject chicken." Taxpayer further states that the chemical coolant "is a component part of the machine just as tanks, valves and hose are component parts of the machine. As such, the propylene glycol is exempt pursuant to IC 6-2.5-5-3." Taxpayer writes that it has "confirmed that the only use of propylene glycol by the plant is in this machine." The Department is prepared to agree that Taxpayer has met its burden of establishing that the coolant is exempt pursuant to the cited statute.

**FINDING**

Taxpayer's protest is sustained.

**SUMMARY**

On Taxpayer's objection that its evaporation equipment is integral to the function of the exempt refrigeration equipment, Taxpayer's protest is sustained in part; Taxpayer is requested to verify the extent to which the evaporation equipment is integral to function of the exempt refrigeration equipment and to supply that information within 30 days of the date on which this Supplemental Letter of Findings is issued. The computer equipment and chemical coolant is exempt. In all other respects, Taxpayer's protest is denied.

*Posted: 11/30/2011 by Legislative Services Agency*
An html version of this document.